STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 99-851

October 12, 2001

MAINE PUBLIC UTILITIES COMMISSION
Investigation Into Verizon Maine's
Alternate Form of Regulation

ORDER GRANTING REQUESTS FOR RECONSIDERATION;
ORDER GRANTING AND DENYING MODIFICATIONS

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

In this Order we reconsider our Order issued in this case on May 9 and June 25, 2001, pursuant to timely motions for reconsideration filed by the Public Advocate and Verizon. We modify the Order in response to certain of the requests in Verizon's motion and deny all other requests for modification or for further proceedings. We modify that portion of the Order that requires Verizon to reduce its retail toll revenues or rates by $19.8 million by altering the base period and dates by which the reduction must occur. We also modify the Order to reflect proposed changes concerning the Service Quality Index (SQI).

II. DISCUSSION

A. <u>The Public Advocate's Motion</u>

We grant the motion of the Public Advocate (OPA) to reconsider our Order that allowed Verizon Maine to increase its local basic rates, but we do not alter our decision. The Public Advocate argues that the statute permitting the Commission to establish an alternative form of regulation (AFOR) for a telephone utility, 35-A M.R.S.A. §§ 9101-04, does not allow the Commission to order an increase to basic rates without conducting a revenue requirement proceeding. The OPA relies in particular on Section 9103(1), which states:

> For the period of the alternative form of regulation, which may not be less than 5 years nor exceed 10 years without affirmative reauthorization by the commission, ratepayers as a whole, and residential and small business ratepayers in particular, may not be required to pay more for local telephone services as a result of the implementation of an alternative form of regulation than they would under traditional rate-base or rate-of-return regulation.

We addressed this issue in detail in this proceeding both in our Order Denying OPA Request For Revenue Requirement Case (June 20, 2000) and in our

Order on Reconsideration (August 22, 2000). We have little to add to those discussions. We simply do not agree with the Public Advocate that the statute requires a "true-up" of rates to earnings whenever we consider extending the AFOR. We find it significant that the statute does not state that ratepayers may not be required to pay more under the AFOR than under traditional regulation at the moment we renew or reestablish an AFOR. Instead, it applies this mandate "for the period of the alternative form of regulation." That determination is, of course, more difficult to make than the simplistic snapshot approach the OPA appears to urge; we doubt that the OPA's approach would satisfy the requirement of the statute. We believe we may apply our experience under both traditional and alternative regulation to make that determination, and we reaffirm the finding we made in the two prior Orders that customers under the AFOR are not paying more for local service than they would have (or will) under traditional rate-of-return regulation.

The OPA also argues that the Commission violated due process by allowing Verizon to present evidence of its earnings and "testimony requesting specific increases in the price level for its basic service," after the Commission had, at the outset of the AFOR case, ruled that it would not conduct a revenue requirement investigation.

By way of background on this issue, Verizon filed rebuttal testimony on February 16, 2001 and on February 23, 2001 the Public Advocate filed a Motion To Strike Testimony, or in the Alternative, a Renewed Motion For A Rate Investigation. The Examiner denied the first alternative on March 9, 2001, the first day of hearings, and stated that he could not rule on the second alternative because the Commission had ruled that there would be no revenue requirement investigation.

Despite the reference in the OPA's Motion to due process and lack of notice,[1] the OPA is not really making a due process argument.[2] In one alternative, the argument is about relevance: because the Commission had ruled that it would not conduct a revenue requirement investigation, Verizon's testimony should not have been admitted. In the other alternative, the OPA is once again arguing that the Commission should have conducted a revenue requirement investigation, i.e., it too should have had an opportunity to present a revenue requirement case because Verizon was supposedly permitted to do so by the admission of the testimony about earnings. This latter argument overlooks that fact, however, that neither party was permitted to present a revenue requirement case, and that we did not rely on the testimony concerning

[1]The heading to this argument reads: "The Commission's Order Violates Constitutional Due Process by Ordering Increases to Basic Rates Without Notice or an Opportunity for a Hearing on the Revenue Issues."

[2]The reference to "notice" in the heading is wholly undeveloped in the text of the Motion. However, the final Order fully addressed the claim made by the OPA in its briefs that there was insufficient notice that the issue would be considered.

earnings in any way in our final Order (Part 2, June 25, 2001).[3] The Examiner ruled that the testimony concerning specific rate increases was essentially argument about issues that clearly were present in the case in any event. The Part 2 Order also addressed this issue in connection with the OPA's argument raised in its post-hearing briefs that it had not received sufficient notice of the issue.

In short, the proposition that we considered testimony on earnings in setting basic rates is unfounded. As discussed in the Part 2 Order, we based our decision to allow Verizon to increase basic rates entirely on the arguments in the case and the operation of the access parity statute, 35-A M.R.S.A. § 7101-B.

Finally, the OPA argues that the Commission has violated 35-A M.R.S.A. § 7303 (2) and 9103 (4). Section 7303(2) requires the Commission to "preserve traditional flat rate local telephone service at as low a cost as possible, allowing for unlimited local exchange calling for a single monthly fee as the standard phone service in the State for both business and residential customers." We have discussed the import of this provision, and its relationship to the AFOR and access parity statues many times, most recently in the final Order in this case, and we see no need to repeat that discussion here. Section 9103(4) states that the AFOR:

> must provide adequate safeguards to ensure that risks associated with the development, deployment and offering of telecommunications and related services offered by the telephone utility, other than local telephone services, are not borne by the local telephone service subscribers of the telephone utility and that the utility continues to offer a flat-rate, voice-only local service option.

There is no evidence in this case that local telephone subscribers are bearing inappropriate risks. Verizon is, of course, maintaining a flat-rate option; this latter statutory provision says nothing about any particular rate level.

B. <u>Verizon's Motion</u>

We grant Verizon's motion to reconsider our ruling that it must it reduce its retail toll revenues or rates by $19.8 million. We do not eliminate the requirement, but we do modify it. We grant its motion to reconsider certain features of the Service Quality Index (SQI) and modify the SQI pursuant to a proposal filed subsequently.

1. <u>Toll Reduction</u>

[3]As discussed further below, we did rely on some of the testimony concerning alleged access and toll revenue loss. Revenue changes, however, are not the same as changes in earnings. Revenue changes may be relevant under an AFOR, but under the Verizon AFOR earnings are not.

Verizon's Motion for Reconsideration asks, in the alterative, that the Commission eliminate the requirement that it reduce its retail toll rates by $19.8 million; or, if the Commission declines to eliminate the requirement, that it modify it to reflect the fact that Verizon's toll revenue loss estimate was based on December 31, 2000 rates and sales volumes (billing units) rather than those for May 31, 2001. In the Order, we used the latter date, which is the beginning of the revised AFOR, as the starting point for measuring revenue declines or rate reductions.

Verizon argues that the condition is inconsistent with our finding that the retail toll market is competitive and the related decision to allow Verizon pricing freedom for retail toll services. We do not agree that there is an inconsistency. The requirement has nothing to do with a finding that the market is or is not competitive, nor is the Commission seeking to regulate toll prices. The requirement is simply related to the fact that Verizon requested the Commission to allow it to increase basic local rates because it expected to lose revenues due to both the reduction in wholesale access rates that was required by statute (to be effective on May 30, 2001) and the operation of the competitive retail toll market responding to those access rate reductions. We decided that Verizon should be allowed to increase local rates to offset the likely amount of the access rate decrease (including the effects of stimulation), and that we would treat expected increases in productivity, beyond the rate of inflation, as offset by the expected decline in retail toll revenues due to the operation of the competitive market. As long as we are requiring basic ratepayers to pay for a significant portion of decreased interexchange revenues through higher local rates, we believe it is appropriate to ensure that ratepayers also realize retail toll savings.

In its testimony, Verizon estimated that it would lose between $19.8 million and $51 million in retail toll revenue. In deciding to impose the requirement that its retail toll revenues or rates decline by $19.8 million, we used the low end of the range of Verizon's estimates. Verizon presented these estimates (along with its estimate of access revenue loss) in an attempt to convince us that it would lose so much revenue that it would be necessary to increase basic rates. We found that Verizon would lose retail toll revenues. We also found that Verizon could expect productivity in an amount similar to the amount (4.5%) that we found would occur during the first phase of the AFOR, and that that amount of productivity (less inflation) would offset toll losses. We declined to establish a productivity index because of the need to offset toll losses, a decision that significantly benefits Verizon. We therefore have decided that fairness to ratepayers dictates that we ensure that some reasonable measure of toll loss does in fact occur. As a reasonable measure of toll loss, we used the lowest of Verizon's three estimates, which assumes that toll rates will decrease by the same amount (3.5 cents) by which access charges decreased.

Verizon also argued that the condition is inappropriate because it creates a "perverse and uneconomic incentive" to reduce output (i.e., sales) because increasing output would increase revenues, thereby making it more difficult to meet the condition. Verizon's argument appears to overlook the fact that the condition is in the alternative. Verizon may reduce *either* revenues *or* rates. If it chooses to reduce rates, there is no impediment to increasing sales; indeed, lower rates could well lead to greater sales and, perhaps, greater revenues.

In the alternative, Verizon requests that we modify the condition, stating that the condition should be measured from the end of December, 2000, rather than from May 31, 2001. The Motion claims that in developing the $19.8 million estimate, Verizon used revenues and calling volumes for the year ending December 31, 2000 and rates that were in effect on that date. The Motion implies, therefore, that Verizon estimated toll revenue loss from the end of last year,[4] even though the access rate reductions would not occur until May 30, 2001 and the second phase of the AFOR was expected to begin on June 1, 2001. The rebuttal testimony of Mr. Shepard, who presented the estimates, did not state the time period for the revenues or billing units that he used as the base for his estimates. Nevertheless, because Mr. Shepard's testimony was filed on February 16, 2001, it is clear that the estimates are based on data for some 12-month period that preceded his testimony.

Verizon's response to Bench Data Request No. 1, filed on August 9, 2001, claims that its "average effective price per minute" for retail toll declined "approximately 1 percent" between December 31, 2000 and May 31, 2001. Verizon further claimed in that data response that "these reductions…were caused by competitive market conditions which reflect, in part, the anticipatory pass-through of access rate reductions by competing IXCs in the months preceding the scheduled May 30, 2001 access rate reductions." Verizon also admits, however, that "it is impossible to discern what portion of the price decrease and demand volume reductions Verizon Maine has already experienced during the first five months of 2001 is directly attributable to the scheduled and widely-known access rate reduction that took effect on May 30, 2001."

It is not possible to determine with certainty that the toll rate reductions that occurred between January 1 and May 31, 2001 were in "anticipation" of the access rate reductions that would take place on May 30, 2001. The only toll rate reductions that occurred between those two dates were reductions in retail toll rates of $5.11 million adopted on January 1, 2001. Verizon was required to reduce rates on that date because we extended the first phase of the AFOR for six months (from November 30, 2000 to May 31, 2001) and because of the negative change in the PRI, which established overall maximum rate levels under the first phase of the AFOR. Mr. Shepard's rebuttal testimony, filed on February 16, 2001, made no claim that the toll

[4]The Motion states "Verizon did not claim that toll revenues would decline by $19.8 million from prices and quantities existing on May 31, 2001."

revenue loss would occur anticipatorily prior to May 30, 2001, the date of the access reductions, or that some of the anticipatory loss had already occurred on January 1, 2001 in the form of the AFOR rate reductions. Mr. Shepard's testimony might be read to imply future actions: "IXCs reasonably can be expected to lower their toll rate prices when access charges are reduced…" and "Verizon Maine will have to respond to the IXCs' price changes…."

Nevertheless, we agree, based in part on our own observations of the toll markets, that the claim contained in Verizon's data response is plausible. During the first phase of the AFOR, Verizon made five required annual filings in which it adjusted rates in response to changes in the Price Regulation Index (PRI). Over the course of the AFOR, changes in the PRI were always negative, and, in each annual filing, Verizon made a substantial majority of the required reductions to retail toll rates, although it could choose to reduce any rates. In addition to the AFOR filings, Mr. Shepard's testimony presented ample evidence in support of his claim that Verizon's toll prices "have been lowered dramatically over the last three years." The access parity statute was enacted in 1997; the first access rate reduction required by the statue was on May 30, 1999; and the statute requires subsequent reductions every two years thereafter. It is reasonable to conclude that Verizon, during at least the three-year period claimed by Mr. Shepard, and probably longer, has continuously priced retail toll in anticipation of (and in reaction to) access rate reductions and their effects on the competitive toll market. While the January 1, 2001 toll rate reductions were used to satisfy the requirements of the first phase of the AFOR, Verizon had the choice to reduce any rates and likely reduced retail toll rates because of its expectations about the retail toll market, including the effect on that market from the future access reductions.[5]

For the foregoing reasons, we reaffirm the requirement that Verizon must reduce its retail toll revenues or rates by $19.8 million, but we modify the requirement so that the base period will be calendar year 2000 (rather than the year ending May 31, 2001) for the retail toll revenue loss alternative; and so that the base date for the rate comparison will be December 31, 2000 rather than from May 31, 2001. For the revenue comparison alternative, the June 25 Order required a comparison between the year ending May 31, 2003 and the year ending May 31, 2001. Because we have changed the base year to 2000, the comparison year will be calendar year 2002. For the rate comparison alternative, the base date was May 31, 2001 and the comparison date was May 31, 2002, one year later. For the sake of consistency, we change the period for the rate comparison to two years: if Verizon chooses the rate

[5]On August 20, 2001, the Public Advocate filed an objection to Verizon's response to Bench Data Request No. 1, stating that Verizon used the data response to make additional arguments and requesting that the Commission either disregard Verizon's response or allow other parties to "rebut Verizon's inaccurate and procedurally improper assertions." As can be seen from the discussion above, we have relied on evidence in the record and specialized agency knowledge (*see* Chapter 110, § 775) rather than on the assertions in the Data Response.

option, it must demonstrate that retail toll rates on December 31, 2002 are $19.8 million less than the level of those rates on December 31, 2000, using billing units for calendar year 2000 for each of the two rate calculations.

2. SQI

We amend our Order to make changes to the Service Quality Index as proposed in a "draft Stipulation" filed by Verizon on September 6, 2001. We understand that the draft stipulation was arrived at pursuant to discussions and negotiation between Verizon and the Public Advocate in which the Commission advisory staff played an active role. The Public Advocate ultimately did not sign the draft stipulation. Accordingly, there is no formal stipulation to consider. Nevertheless, on the recommendation of advisory staff, we will consider the draft stipulation as a proposal to revise the SQI. The advisory staff recommends that we adopt the proposed changes. The Public Advocate does not oppose the changes.[6]

We find that the propose changes described in the "draft stipulation" (attached to this order) are reasonable and we adopt them.

Accordingly, we

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[6]The Public Advocate stated that it was willing to support Paragraphs 1-6, but not Paragraphs 7-12 because

> there is a significant amount of technical description in these paragraphs, and while it is consistent with the discussions that were held after [Verizon's] motion was filed and after the record was closed, none (or not much) of this information is actually in the record. If the OPA were to agree to these portions of the stipulation, we would in effect be agreeing that all this information forms a record upon which the Commission can base its decision, something I am reluctant to do. So, while I will not oppose the outcome suggested in paragraphs 7 through 16, I will decline to join in that part of the stipulation.

Chapter 110, § 743 of the Commission's Rules governs consideration of uncontested stipulations and (in contrast to section 744, which governs contested stipulations) contains no express requirement that an uncontested stipulation be based on record evidence. The Commission may accept an uncontested stipulation "if it determines the stipulation to be in the interest of the participating parties and the public."

1. That the condition, contained in the Order of June 25, 2001 that Verizon demonstrate that its retail toll revenues have declined by $19.8 million as of May 31, 2003, or that its retail toll rates have been reduced by $19.8 million as of May 31, 2002, is modified as follows:

a. Verizon shall demonstrate that its retail toll revenues in the calendar year 2002 are $19.8 million less than in the calendar year 2000; or

b. Verizon shall demonstrate that its retail toll rates on December 31, 2002 are $19.8 million less than those on December 31, 2000, using billing units for calendar year 2000[7] for both rate calculations;

2. That the SQI is modified as described in the "draft stipulation " filed on September 6, 2001, attached hereto and made a part of this Order; and

3. That Verizon shall, within 30 days of this Order, file its retail toll revenues for 2000 and its retail toll rates as of December 31, 2000 (listed by rate element and showing the billing units for each rate element for calendar year 2000).

Dated at Augusta, Maine, this 12th day of October, 2001.

BY ORDER OF THE COMMISSION

____
Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Diamond

[7]If Verizon chooses this rate option it shall use actual billing units for the year 2000 rather than any estimated billing units it may have used in developing the estimates, and submit those billing units as soon as they are available.

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.